



1 BEFORE THE ARIZONA CORPORA'

2

3 IN THE MATTER OF:)

4 RICHARD M. SCHMERMAN, individually)
and d/b/a Diversified Financial)
5 and/or Diversified Financial)
Planners, and Amy Schmerman,)
6 husband and wife.)

DOCKET NO.
S-20757A-10-0373

EVIDENTIARY
HEARING

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8

9 At: Phoenix, Arizona

10 Date: October 2, 2013

11 Filed: **OCT 22 2013**

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REPORTER'S TRANSCRIPT OF PROCEEDINGS

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VOLUME III

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Pages 374 through 446, inclusive

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Arizona Corporation Commission

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By: GARY W. HILL, RPR, CRR
Certified Reporter
Certificate No. 50812

23

24 Prepared for:

25 ACC

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3			
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5		for Richard Mark Schmerman as	
6		a securities salesman for the	
7		periods of November 6, 1986,	
8		to March 13, 2008, and May 15,	
9		2008, to March 10, 2010, and	
10		as an investment adviser	
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4		America dated March 29, 2010, with		
5		United Planners Financial Services		
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10		Aiken for \$12,784.15, e-mail to		
11		Richard Schmerman requesting		
12		additional information regarding		
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NO.	DESCRIPTION	IDENTIFIED	ADMITTED
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1	NO.	DESCRIPTION	IDENTIFIED	ADMITTED
2	S-28a	Fidelity National Law Group		
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4		Division on July 5, 2011 with		
5		escrow files for escrow		
6		# ST09008204-ST54, Affidavit of		
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8		Title Agency dated June 30, 2011,		
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10		produced by Fidelity National Law		
11		Group	323	21
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7		dated October 7, 2011, and from		
8		Ann Draganich to Diversified		
9		Financial dated October 20, 2011;		
10		Diversified Financial billing		
11		statement for March 31, 2010,		
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36		Shirley Stowe on January 23, 2006,		
37		and March 21, 2006	279	21

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1	NO.	DESCRIPTION	IDENTIFIED	ADMITTED
2	S-42a	Letter to Securities Division		
3		from M&I Bank dated May 27, 2011,		
4		with Subpoena and copies of checks		
5		to Schmerman Buildings LTD and		
6		Richard Schmerman, and affidavit		
7		of custodian of records	--	21
8	S-42b	Signature card for Schmerman		
9		Buildings LTD	--	21
10	S-43	Letter to Securities Division from		
11		US Bank dated May 27, 2011,		
12		affidavit of custodian of records		
13		and image of CD	--	21
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22		# ****-1069, copy of subpoena	--	21
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24		Financial and Richard Schmerman	--	21
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27		# ****-1069, copy of subpoena	--	21
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36		dated June 8, 2011 for account		
37		# ****-0016, copy of subpoena	--	21

NO.	DESCRIPTION	IDENTIFIED	ADMITTED
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1	NO.	DESCRIPTION	IDENTIFIED	ADMITTED
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3		** Supporting Documentation is		
4		available for copying or review		
5		at the Division prior to the		
6		scheduled hearing date upon		
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22		** Supporting Documentation is		
23		available for copying or review at		
24		the Division prior to the		
25		scheduled hearing date upon		
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		Waiver and Consent with Richard		
		Mark Schmerman dated August 2,		
		2011	240	21
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		and Rita Pellish, hand-written		
		investment summary with attached		
		client forms, account statements		
		and checks	56	21

1	NO.	DESCRIPTION	IDENTIFIED	ADMITTED
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3		printed 3/10/2013 with attachments	69	21
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5		copies of statements and checks	--	21
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7		dated September 29, 2000, with Form ADV Part II dated March 28,		
8		1997, checks, account statements, and Limited Power of Attorney	101	21
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17				
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19	S-68	Composite of Audio Recordings identifying caller name to Charles Schwab	303	Not Offered
20				
21	S-69a	Charles Schwab cover letter dated August 14, 2013	301	21
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16		Schmerman	235	240

17

18 (NOTE: Exhibit S-58a not utilized.)

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1 BE IT REMEMBERED that the above-entitled and
2 numbered matter came on regularly to be heard before the
3 Arizona Corporation Commission, in Hearing Room 2 of
4 said Commission, 1200 West Washington Street, Phoenix,
5 Arizona, commencing at 9:32 a.m. on the 2nd day of
6 October, 2013.

7

8 BEFORE: MARC E. STERN, Administrative Law Judge

9

10 APPEARANCES:

11

12 For the ACC Securities Division:

13 Mr. Phong Paul Huynh
14 Staff Attorney, Legal Division
15 1300 West Washington Street
16 Phoenix, Arizona 85007

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19 GARY W. HILL, RPR, CRR
20 Certified Reporter
21 Certificate No. 50812

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1 ALJ STERN: We're back on the record in the
2 matter of Richard Schmerman, et al, in Docket
3 No. S-20757A-10-0373. My name is Marc Stern. I'll
4 preside today. At this time, I'll take an appearance on
5 behalf the Division.

6 MR. HUYNH: Good morning, Your Honor. Phong
7 Paul Huynh on behalf of the Division, and with me at the
8 table is special investigator Greg Thomsen and Karen
9 Houle.

10 ALJ STERN: We'll note for the record, as has
11 been in the past, Mr. Schmerman is not present, and
12 we're ready to go. So you want to continue your
13 examination of this witness?

14 MR. HUYNH: Yes. Thank you, Your Honor.

15

16 SEAN MICHAEL CALLAHAN,
17 called as a witness on behalf of ACC Securities
18 Division, having been previously duly sworn by the
19 Certified Reporter to speak the truth and nothing but
20 the truth, was examined and testified as follows:

21

22 DIRECT EXAMINATION CONTINUED

23 BY MR. HUYNH:

24 Q. Good morning, Mr. Callahan, good morning, Your
25 Honor. Mr. Callahan, I would like you to flip back to

1 S-59, and I just wanted to do a very quick summary on
2 those exhibits.

3 A. Okay.

4 Q. And starting with S59a, just as a quick review,
5 so based on this report and analysis, did Mr. Schmerman
6 use customer funds for his own personal benefit?

7 A. Yes, he did.

8 Q. And based on --

9 A. Well, he used -- I don't know how he used it
10 other than he took it, and a lot of times he took it out
11 as cash. So he used it for not for what the investor
12 thought it was going to be the intended purpose. So
13 once he took it out in cash, he spent it however he
14 wanted to spend it. You understand what I'm saying?

15 Q. I think so. So based on your report, the
16 customer funds were not used to purchase securities or to
17 invest as they intended?

18 A. Correct.

19 ALJ STERN: Just so I clarify, so in other
20 words, the funds, let's say -- I can't remember the name
21 of an investor directly right now, but let's say an
22 investor --

23 THE WITNESS: The Beauvais.

24 ALJ STERN: Okay. The Beauvais gave him how
25 many hundreds of thousands, roughly?

1 THE WITNESS: Well, I know there was a \$100,000
2 deposit early on in 2005, but they were long-time
3 clients before that, so I know that \$100,000 was
4 deposited.

5 ALJ STERN: So let's say \$100,000 would come
6 from the Beauvais, for example. And then that money,
7 would it be deposited into his personal account
8 directly? Or was it deposited into Richard Schmerman,
9 dba his business account for Diversified?

10 THE WITNESS: Typically it went to the
11 Diversified.

12 ALJ STERN: And then the money --

13 THE WITNESS: Then he would transfer it over to
14 his personal account.

15 ALJ STERN: Okay, either by wire or --

16 THE WITNESS: Or just taking out cash. He had a
17 lot of cash deposits or cash withdrawals.

18 ALJ STERN: I imagine. Go ahead. Mr. Huynh.

19 MR. HUYNH: Sure thing, Your Honor.

20 BY MR. HUYNH:

21 Q. Mr. Callahan, flipping to S-59b?

22 A. Okay.

23 Q. And just to clarify here, where did this \$7,000
24 deposit come in from again and whose Schwab account was
25 that?

1 A. That \$7,000 deposit from Charles Schwab was out
2 of the account of the Beauvaises, and that got deposited
3 into the Beauvaises' SunWest account. And then it was
4 transferred -- a check was written to Diversified
5 Financial for the entire amount.

6 Q. So based on this report, were these customer
7 funds used to invest or purchase securities for the
8 Beauvaises?

9 A. At one time they were, but they were taken
10 out -- this was actually, I believe it was after the
11 Beauvaises had actually died. So he was in charge as
12 the trustee.

13 Q. So based on this report, did Mr. Schmerman use
14 this for either his personal expenses or benefit?

15 A. Yes.

16 Q. Similarly, if you would flip over to S-59c.

17 A. Okay.

18 Q. Just to clarify again, S-59c is a \$368,000
19 deposit, and is that the Beauvais home purchase into this
20 SunWest Credit Union account?

21 A. Yes, this is the home sale.

22 Q. So based on this amount, did Mr. Schmerman use
23 these client funds for his personal benefit or uses?

24 A. Yes.

25 Q. Let's move over to S-59d.

1 A. Okay.

2 Q. And in S-59d there are multiple investors named
3 here that their monies were deposited. Again, just for
4 the record, which account are those investor monies being
5 deposited into?

6 A. They were being deposited into Diversified
7 Financial.

8 Q. The Wells Fargo Bank account number ending in
9 0016?

10 A. Yes.

11 Q. And were any of those investor monies used to
12 purchase securities based on this report?

13 A. No.

14 Q. And based on this exhibit and report, were the
15 investor monies used by Mr. Schmerman for his own personal
16 benefit or personal expense?

17 A. Yes. They were used to pay off a debt, a
18 personal debt.

19 Q. In looking at S-59e --

20 A. Okay.

21 Q. -- I think we briefly touched on this.

22 Mrs. Gloria Aiken's \$175,000, were those funds used to
23 purchase any securities or stocks on behalf of Gloria
24 Aiken or Elizabeth Aiken?

25 A. No.

1 Q. And finally, your S-59f.

2 A. Okay.

3 Q. Mrs. Robinson's \$373,000, were those funds used
4 to purchase securities or stocks for the Robinsons?

5 A. No. \$25,000 was used for Charles Schwab
6 investment, but it was not directly put into an account
7 for Mrs. Robinson.

8 Q. So based on this report and exhibit, did
9 Mr. Schmerman use any of the monies for unintended
10 purposes, or I guess what is the best way to say that?

11 A. He used it -- he didn't use it for the intended
12 purpose of buying investments for Mrs. Robinson. He
13 either transferred the money to his personal account or
14 to cash withdrawals or used it to pay other investors.

15 Q. Thank you. I would like to look at a couple
16 specific examples, I think you've created, as Exhibits
17 No. S-71, and I believe there is an A through F.

18 A. Okay.

19 Q. And please walk me through this first Exhibit,
20 S-71a, what account are you looking at? What is the time
21 frame, and who are we focusing in on?

22 A. This is a listing of all the transactions
23 affecting the account of the Diversified Financial
24 account with the last four digits 0016 covering December
25 of 2009, and it's for every transaction larger than

1 \$1,000, and the authorized signature in this account is
2 Richard Schmerman. We're focusing in on the final
3 deposit of \$20,000 that Judy and Rita Pellish gave for
4 the sole purpose of buying bonds, and that deposit
5 happened on December 17, 2009.

6 Q. And so what happened after Mrs. Pellish's \$20,000
7 was deposited into the account? How did Mr. Schmerman use
8 those funds?

9 A. The next day he wrote -- he used, took out
10 approximately the \$20,000 in three ways. He gave a
11 check for \$10,000 to Elizabeth Aiken, and that \$10,000,
12 he bought an official check, which is a bank check, for
13 the \$10,000. He took out a cash withdrawal of \$6,200,
14 and then finally he bought another cashier's check or
15 official check from the bank in the name of Bernice C.
16 Elson for \$3,800.

17 Q. So based on this exhibit, then Mrs. Pellish's
18 money was not invested in bonds then?

19 A. No, it was used in those three transactions.

20 ALJ STERN: Again, this is the Wells Fargo
21 account for --

22 THE WITNESS: Diversified Financial.

23 ALJ STERN: Okay, go ahead. Sorry.

24 MR. HUYNH: No problem, Your Honor.

25 BY MR. HUYNH:

1 Q. So based on this report here, did Mr. Schmerman
2 use the funds for, not for its intended purposes?

3 A. That's correct.

4 Q. And based on the \$6,200 cash withdrawal from that
5 \$20,000, did Mr. Schmerman potentially get some of that as
6 a personal benefit?

7 A. There's no way to say what he did with it. He
8 could have had personal benefit. He could have done
9 anything with it.

10 Q. Let's flip over to the next exhibit.

11 A. Okay.

12 Q. S-71b. Again, if you could, just for the record,
13 give me an overview of the bank account, the time frame,
14 and whose account we're looking at here.

15 A. Okay. Again, this covers the Diversified
16 Financial account, last four digits of 0016, and the
17 authorized signer is Richard Schmerman; and this covers
18 the deposits made by Burritt Steward. The first one is
19 in July of '05, and that happened on July 22 of '05 for
20 \$162,620.54.

21 And then there was a second deposit on May 3 of
22 2006 for \$86,897, and a final deposit on May 20 of 2010
23 for \$100,000.

24 Q. Okay. So let's look at the July 22, 2005,
25 deposit of \$162,000.

1 A. Okay.

2 Q. I think we saw this in one of your exhibits, but
3 just to confirm, how was Mr. Steward's money used?

4 A. It was taken out five days later and used as
5 part of the cashier's check that was made to the Estate
6 of Ruth Gunston and the proceeds used for repayment of
7 the Gunston estate debt, personal debt that
8 Mr. Schmerman had.

9 Q. So just to be clear here, Mr. Steward's \$162,000
10 never made it into any type of a security or investment on
11 his behalf?

12 A. No, it did not.

13 Q. Let's walk through on May 3, 2006, there's a
14 deposit into this account for Mr. Steward of \$86,000,
15 roughly. What happened to that fund?

16 A. That money was used not for its intended
17 purposes either. The next day on May 4, he had a
18 \$15,000 withdrawal, which I'm assuming is a cash
19 withdrawal. A \$10,000 cashier's check was purchased and
20 made out to Charles Schwab Institutional, but that
21 cashier's check was not used for its intended purposes
22 and was then deposited back into Schmerman's personal
23 account. And then he also purchased a \$10,000 cashier's
24 check made to Reba Varela, V-A-R-E-L-A. But again, that
25 cashier's check was not used for its intended purposes

1 and was deposited back into Mr. Schmerman's personal
2 account.

3 Q. Just to be clear for those two. So he wrote out
4 cashier's checks made out to other entities or
5 individuals. Never gave it to those individuals; is that
6 what you're saying?

7 A. That is correct. And then he took the money and
8 deposited from his, because the money came from the
9 business, the Diversified account, and then he deposited
10 the money in his personal account.

11 Q. Okay. Okay.

12 A. Let's see. The next day on May 5, he took out a
13 \$7,000 withdrawal. He took out a second \$7,000
14 withdrawal, and then he took out a third \$6,000
15 withdrawal. So right in those two days he has taken out
16 10, 20, 35, 45, \$55,000 of the \$86,000.

17 Q. And so at least for that portion, Mr. Steward's
18 money, you show here, never made it into any type of
19 securities or investment for him?

20 A. Not that I'm aware of, no.

21 Q. Now, you show here there's a remaining balance of
22 around \$31,000. Do you recall whether any of that money
23 made it into an investment or anything for him?

24 A. No, I don't recall off the top of my head.

25 Q. Now, let's go through the \$100,000 that's

1 deposited for Mr. Steward in May of 2010. What happens to
2 that money?

3 A. That money was deposited on, let's see, May 20,
4 2010. The next day on May 21, there are three checks.
5 The first one, he purchased a cashier's check and made
6 it out to Bernice C. Elson for \$50,000. A \$20,000
7 cashier's check was purchased on behalf of the C and P
8 Beauvais Trust, and finally he purchased another
9 cashier's check made payable to Frances V. Potter for
10 \$3,906.14.

11 And then on May 25, he took out \$15,000 as a
12 withdrawal. And finally, on May 28, he took out \$11,000
13 as a withdrawal, leaving \$93.86.

14 Q. So for Mr. Steward's \$100,000 transaction there,
15 it appears basically none of the money made it into any
16 stocks or investments for his benefit?

17 A. That is correct.

18 Q. Let's move over to your next exhibit, S-71c.
19 Again, if you could give us an overview of the account
20 you're looking at here and who the authorized signers are
21 and the time frame.

22 A. Okay. This is again Diversified Financial's
23 account, last four digits 0016. Authorized signer is
24 Richard Schmerman. And this schedule is used to show
25 what happened to Peter Kallgren's deposit, and that

1 deposit happened on November 22 of 2005 for \$218,000;
2 and then there's a listing of how the money was spent.

3 Q. Okay. And could you go through, just in general,
4 did any of this money make it into stocks or securities,
5 an investment for Mr. Kallgren's benefit or behalf?

6 A. Not that I'm aware of except for one \$20,000
7 Charles Schwab check, and that was a cashier's check
8 purchased on December 2 for \$20,000.

9 Q. Okay. Now --

10 ALJ STERN: Was that check for --

11 THE WITNESS: For Peter Kallgren's benefit?

12 ALJ STERN: Yeah.

13 THE WITNESS: Not that I'm aware of. I think it
14 went into the main account.

15 ALJ STERN: You mean, when you say the main
16 account, whose account is that?

17 THE WITNESS: That would be under, I believe
18 Diversified Financial's account, so he pooled all the
19 money into that account.

20 ALJ STERN: And he used that account to sort of
21 draw money -- he invested money through Diversified
22 Financial; and then if he took money from that, then he
23 would sometimes pay investors, I guess.

24 THE WITNESS: Correct.

25 ALJ STERN: Okay. Go ahead, Mr. Huynh.

1 MR. HUYNH: Thank you, Judge.

2 BY MR. HUYNH:

3 Q. Now, Mr. Callahan, after the \$218,000 comes in on
4 November 22, 2005, what is the very next transaction you
5 have listed there?

6 A. It's a transfer to his personal account for
7 \$54,000 on the 23rd.

8 Q. And then the very next set of transactions you
9 have there are just cash withdrawals taken by
10 Mr. Schmerman?

11 A. Correct.

12 Q. Who are the authorized signers on this 0016
13 account?

14 A. It's just Mr. Schmerman.

15 Q. Throughout this entire time frame we've been
16 talking about, it's just been Mr. Schmerman?

17 A. Yes.

18 Q. Thank you, Mr. Callahan. Let's move over to
19 S-71d. If you could, same thing, just give us a
20 background on this exhibit here.

21 A. Sure. This is again a cash flow of what
22 happened with the account is covering Diversified
23 Financial. The last four digits are 0016. The
24 authorized signer is Richard Schmerman. And this is
25 what happens with Bernice Elson's deposits. She made

1 two of them. The first one dated July 28 of '06 in the
2 amount of \$233,103.97, and the second deposit happens on
3 September 30 of 2008 for \$125,000, and this schedule
4 just shows how the money was spent following those two
5 deposits.

6 Q. So let's start with the \$233,000 on 7-28-06.
7 What is the next transaction you have listed there showing
8 being debited out from that?

9 A. It's a payment to Peter Kallgren for \$500, and
10 then in the memo it said Return of Investment. Again,
11 that amount was for \$500.

12 Q. And that memo, that is a description that you
13 received either from the check or from the wire transfer
14 detail?

15 A. I believe it was -- yes, it was -- he debited
16 his account and credited, transferred it over there. I
17 think that's what it said on the bank statement.

18 Q. And you also -- based on this cash flow here, did
19 Mr. Schmerman also transfer some of the funds to his own
20 personal account?

21 A. Yes, he did.

22 Q. How many occasions do you see that occur here?

23 A. One, two, three -- four different times.

24 Q. Now, out of Mrs. Elson's \$233,000 that came in
25 7-28-06, you have by the end of August that amount is down

1 to about \$75,000?

2 A. That's correct.

3 Q. So between that amount, were those funds used to
4 invest in securities or some type of an investment for
5 Mrs. Elson?

6 A. Not that I'm aware of. There was only one
7 investment that I could see for Senate Broker Services
8 for \$7,500 on 7-31-06. But I do not know who is the
9 actual owner of that account.

10 Q. So you were giving Mr. Schmerman the benefit of
11 the doubt that it would go to that investor, or you were
12 giving him the benefit of the doubt in that regard then?

13 A. Yeah, at least it went into an investment.

14 Q. Now, let's look at the \$125,000 received from
15 Mrs. Elson on 9-30-08. Walk us through, what happens to
16 that amount?

17 A. Okay. The \$125,000 was deposited on September
18 30. October 1st of '08 there's a \$25,000 cashier's
19 check purchased in the name of George L. and Judith
20 Cannon. On October 2, there is a \$25,000 transfer to
21 his personal account. On 10-10 of '08 there's a \$50,000
22 purchase of a cashier's check for the Charles Schwab
23 Institutional account. On 10-10 of '08 there is a
24 \$15,000 withdrawal, and it was a transfer to his
25 personal account. On October 14, there is a \$5,000 cash

1 withdrawal; and finally on October 15, again, there was
2 a wire transfer to Charles Schwab and Company of
3 \$11,000.

4 Q. So besides the \$50,000, the rest of -- I'm sorry.
5 How much went to actually Schwab that you credited
6 possibly?

7 A. \$61,000.

8 Q. \$61,000. So the remaining amount, were those
9 used to invest in securities or stocks for Mrs. Elson?

10 A. No.

11 Q. And give me just a second here. You mentioned
12 there was a \$25,000 payment to the Cannons on 10-1-08?

13 A. Correct.

14 ALJ STERN: As far as Mrs. Elson, did she ever
15 get much money back?

16 THE WITNESS: No.

17 ALJ STERN: Any money?

18 THE WITNESS: I can't recall off the top of my
19 head. We have that in our restitution.

20 BY MR. HUYNH:

21 Q. Give me just a moment here. Mr. Callahan, were
22 you aware that Mr. Schmerman had entered into a couple
23 promissory notes with the Cannons?

24 A. Yes.

25 Q. All right. And do you know if one of those

1 payments were to pay the Cannons back for that promissory
2 note or the loan he took out from them?

3 A. I had assumed that the payments made to the
4 Cannons were made on behalf of that promissory note.

5 Q. Okay. Let's go on to the next exhibit then.

6 A. Okay.

7 Q. Actually, could you give us an overview here just
8 to make sure. We're on S-71e; is that correct?

9 A. Yes.

10 Q. Who is this account that you're analyzing here
11 and the time frame?

12 A. This is -- I'm analyzing the business account,
13 last four digits 0016. The authorized signer is
14 Mr. Schmerman. This is covering the time period of
15 January of 2006, and it's going to analyze the deposit
16 of Sandra Robinson's deposit for investment that
17 occurred on January 4 of 2006 in the amount of \$373,390.

18 Q. Let's walk through -- why don't you provide me
19 some of the large debits that you see out of the account?
20 Particularly, I see one on 1-6-06 of \$54,000. Who did
21 that go to?

22 A. That was debited by Richard Schmerman, and he
23 had a withdrawal slip. So I believe that was -- that
24 was just a payment to Mr. Schmerman.

25 Q. Were there other occasions where Mr. Schmerman

1 took out withdrawal slips to himself like that?

2 A. Yes, there were several of them. He had on
3 January 20 a \$40,000 withdrawal and payment to himself.
4 He also had on January 24 a \$30,000 payment --
5 withdrawal and payment to himself. That would be the
6 largest ones.

7 Q. Okay. In general, based on this report here, did
8 you see -- what amounts, if any, did you see actually
9 possibly being invested on behalf of Mrs. Robinson?

10 A. On January 10, there is a \$10,000 cashier's
11 check purchased for the Charles Schwab Institutional
12 account. There is --

13 ALJ STERN: But that went into his own account
14 though, right?

15 THE WITNESS: Yeah.

16 ALJ STERN: It's Diversified Financial.

17 THE WITNESS: Diversified Financial. Not into
18 her name. Into her account.

19 ALJ STERN: So just sort of a pool?

20 THE WITNESS: Correct. A \$1,200 payment to
21 Charles Schwab Institutional account on 1-20. A \$14,400
22 cashier's check was purchased for Charles Schwab
23 Institutional account on January 23. And finally a
24 \$6,240 cashier's check was sent to the Charles Schwab
25 Institutional account on January 31.

1 BY MR. HUYNH:

2 Q. Okay. So other than those, the bulk of the money
3 of Mrs. Robinson, were they used for investments for her
4 behalf or for her benefit then?

5 A. No.

6 Q. You have quite a few cash withdrawals being
7 detailed here; is that correct?

8 A. That is correct.

9 Q. And there's also a lot of names of checks written
10 out to other individuals, like I see Shirley Berman of
11 \$3,000 on 1-20-06. On the same day Bettye Hempel for
12 \$15,000. A George and Judith Cannon for \$10,000. A few
13 days later there's a \$500 payment to Gloria Aiken, and
14 there's also a \$500 payment to Peter Kallgren.

15 Are those all the actual checks that were sent
16 out from that account then?

17 A. Yes, and then also there's a payment to the
18 Beauvais on January 17.

19 Q. Okay. So based on your report and this analysis
20 here, were Mrs. Robinson's funds used for generally the
21 intended purpose of investing for her benefit?

22 A. No.

23 Q. Now, on the next page, looks like you've got an
24 additional two pages attached to this report. Can you
25 explain to us what the difference is on the following two

1 pages here and how you've got a different account number
2 or what that account number is?

3 A. Yes. I just wanted to give an example of when
4 the money went over to his personal account, and this is
5 a schedule reflecting now Mr. Schmerman's personal
6 account at Wells Fargo, last four digits 1069, and he is
7 the authorized signer, and this is how, once the money
8 was deposited from Diversified Financial, how it was
9 spent.

10 Q. So, for example, on the first page we saw a
11 \$54,000 debit from the 0016 account. On this page on
12 1-6-06, we see the \$54,000 coming into this account,
13 you're saying?

14 A. That's correct.

15 Q. So what happened after the money came into this
16 account? How did he use some of those large funds?

17 A. He immediately on January 6 made a payment with
18 Check No. 10574 to a Joseph D. Jordan, Jr., in the
19 amount of \$54,333.33.

20 Q. And further down on 1-20-06, you see you have
21 \$40,000 again. This is coming in from the business 0016
22 account; is that correct?

23 A. That's correct.

24 Q. What did he do once he received that \$40,000?

25 A. The same day on January 20, he cut a check,

1 Check No. 10579 to an Eldon Diamond in the amount of
2 \$30,239.

3 Q. And on 1-24-06 when he transferred \$30,000 over,
4 what did he do with those funds?

5 A. The big expense was on January 24 of '06, he
6 made a check out, Check No. 10750, to a Pershing, LLC,
7 account number, last four digits is 1241, in the amount
8 of \$20,000.

9 Q. Okay.

10 A. Then he also made a check out to Park 12 Trust
11 account on Check No. 10724 in the amount of \$2,764.75 on
12 January 26.

13 ALJ STERN: What is that Pershing, LLC? Is that
14 anything we know previously?

15 THE WITNESS: No. I think it's an investment
16 account, but I don't know whose account number that is.

17 ALJ STERN: Okay.

18 BY MR. HUYNH:

19 Q. So Mr. Callahan, you know, when the money comes
20 into, after the money comes into Mr. Schmerman's personal
21 account, do you see it then being invested for
22 Mrs. Elson's benefit even if you go that extra step?

23 A. Just the last two items I pointed out where it
24 said to the Pershing and the Park 12.

25 Q. But as far as you know, Joseph D. Jordan and

1 Eldon Diamond are not securities, entities or
2 individuals?

3 A. No.

4 Q. And on your next page, is the next page just a
5 continuation of the personal 1069 account?

6 A. Yes, it is.

7 Q. And it's just showing what the value of the
8 account is at the end of January 2006?

9 A. Not the balance, but just the money that flowed
10 through that, for that particular month.

11 Q. Okay. And so --

12 A. He ended up, his account increased by \$6,695.

13 Q. Thank you. Let's move over to S-71f. If you
14 could, give us an overview, what account you're looking at
15 here and the time frame.

16 A. Certainly. Again, this is the business account,
17 the Diversified Financial, last four digits, it should
18 be -- I have it 1069, but that should be 0016.

19 Q. Okay.

20 A. Authorized signer, Richard Schmerman. And this
21 is to reflect the transactions that occurred after Scott
22 Stowe made a deposit. Mr. Stowe made the deposit on
23 August 17, 2005, for \$150,000.

24 Q. And what happened after Mr. or Mrs. Stowe's
25 \$150,000 came into the account?

1 A. It was either taken out through withdrawals,
2 transfers to Mr. Schmerman's personal account, or spent
3 in, I see a \$10,000 check goes to the Charles Schwab
4 Institutional account on September 6, 2005.

5 Q. Okay. Now, besides the \$10,000 to Charles
6 Schwab, did you see any other possible brokerage accounts
7 or security investments on behalf of the Stowes?

8 A. No. But it should be noted that on September
9 29, \$9,870 came back from Charles Schwab as a deposit.

10 Q. So just to be clear here, so on 9-6, he sends a
11 check to Schwab Institutional, but on 9-29 he gets back
12 \$9,870?

13 A. Yes.

14 Q. So it's pretty much a wash there then?

15 A. Yes.

16 Q. So based on this report and analysis, was Mr. or
17 Mrs. Stowe's \$150,000 used for investment purposes for
18 their benefit or on their behalf?

19 A. No, it was not.

20 Q. Mr. Callahan, after you reviewed the bank
21 statements and the nonfinancial documents also, did you
22 put together a restitution list?

23 A. Yes, I did.

24 Q. Let's take a look at, I believe, S-58.

25 A. Okay.

1 Q. Do you recognize this document?

2 A. Yes, I do.

3 Q. Can you describe real briefly what it is?

4 A. This document I prepared based on the analysis
5 that I did, and it's several pages long, six pages in
6 length. It lists the investors that were identified,
7 the date of their original investment, the amount less
8 any repayment, and the outstanding balance that's due,
9 currently due.

10 Q. And you basically have it alphabetized by last
11 name here?

12 A. Yes, and it's broken down into three sections.
13 The first is investors. The second are the IA fees that
14 were charged, and they were charged after the date that
15 you had supplied to me, and the last section contains
16 individuals and the trusts that are owed money.

17 Q. Okay. So let's look at -- so regarding the first
18 section, those are the amounts received from individuals
19 identified as investors and their outstanding amounts.

20 Now, you spoke about IA fees. Do you remember
21 roughly the date or time frame you used as a cutoff?

22 A. I don't have that in front of me, but I'm sure
23 you could supply that for me.

24 Q. Give me just a second here.

25 ALJ STERN: You say IA fees, these were fees

1 that were due to Mr. Schmerman?

2 MR. HUYNH: Well, that's what we're going
3 through.

4 BY MR. HUYNH:

5 Q. Mr. Callahan, maybe it would be helpful to you.
6 Can you access Exhibit No. S-1, S-1a.

7 A. Yes.

8 Q. And based on, do you have S-1a in front of you?

9 A. Based on what?

10 Q. Do you see -- do you have S-1a in front of you?

11 A. Yes, I do.

12 Q. So this is a certification going over the time
13 frames that Mr. Schmerman was registered as a securities
14 salesman representative and investment adviser
15 representative.

16 A. Okay.

17 Q. And do you see towards the center there that it
18 notes that during the period of June 3, 2008, to March 10,
19 2010, so March 10, 2010, Mr. Schmerman was licensed as an
20 investment advisory representative with United Planners?

21 A. I see that.

22 Q. And then for March 11, 2010, through August 15,
23 2012, Mr. Schmerman has not been registered as a
24 securities salesman dealer or investment adviser or
25 investment adviser representative. Does that help you

1 refresh your memory on the time frame you used?

2 A. Yes, it does.

3 Q. So do you remember now, what was the time frame
4 you used to calculate investment advisory services?

5 A. It was the fees he collected as an investment
6 adviser that he received after March 11, 2010.

7 Q. Okay. So just to be clear here. So this
8 restitution list is basically just accounting for all the
9 fees that he charged and received after he became
10 unlicensed then?

11 A. That's correct.

12 Q. Okay.

13 ALJ STERN: Wait, so I understand, so then
14 you're saying on S-58, we're talking the period from
15 March 11, 2010, to August 15, 2012?

16 THE WITNESS: Yes, just for the IA fees.

17 MR. HUYNH: For the investment advisory fee
18 section that you have here in this exhibit?

19 THE WITNESS: Yes.

20 ALJ STERN: But even during the period he's
21 licensed, you're not saying that he was entitled to
22 adviser fees for some of the things he was doing?

23 MR. HUYNH: Mr. Callahan, your report is just
24 calculating as a clean break when he was unlicensed, and
25 everything that was charged while he was unlicensed? Is

1 that what your report does?

2 THE WITNESS: Yes.

3 ALJ STERN: Okay. I mean I understand what
4 you're saying, but --

5 BY MR. HUYNH:

6 Q. For the purpose of your report, that's the time
7 frame you took into account to make those calculations,
8 right?

9 A. For the restitution, yes.

10 Q. Okay.

11 A. We have the fees, just so everyone knows, that
12 he collected during this entire time frame. If that
13 wants to be added in there by the Judge, I could provide
14 that for him.

15 Q. Let's just, you know, complete --

16 A. What we're doing.

17 Q. -- this exhibit here first.

18 So for restitution purposes, you have added
19 everything from the investors from January '05 to roughly
20 your time frame of April 2012 for the investor sums there?

21 A. Correct.

22 Q. For the investment advisory fees though, you
23 chose a clean cutoff date of anything after March 11,
24 2010, that you saw he charged for people when he was
25 unlicensed?

1 A. Correct.

2 Q. Okay. And what is the third section you have in
3 this restitution list?

4 A. The final section, I just have description as
5 others, and it lists two names. The first is the
6 C and P Beauvais Trust, and that was the original amount
7 that I could see going in there on their behalf for
8 that -- I should say money that was taken from the
9 C and P Beauvais Trust, from their trust account, taken
10 by Mr. Schmerman.

11 Q. Okay. And in regards to Mike and Pat Durand, do
12 you remember seeing any type of a notation on the check
13 that the Durands gave Mr. Schmerman?

14 A. Well, this is actually from Mike, I believe Mike
15 Durand's IRA, and it was a loan for \$375,000 that
16 Mr. Durand's IRA gave to Mr. Schmerman personally; and
17 Mr. Durand is, I believe, a client of Mr. Schmerman's.

18 Q. So how was it noted it was a loan? Do you
19 recall?

20 A. It said "loan" on the memo line of the check.

21 Q. Okay. Thank you. So as you've summed up or as
22 this report sums up, it accounts for nearly \$4,000,000 of
23 money coming in to Mr. Schmerman from these investors, and
24 you've accounted for nearly a million dollars being repaid
25 back or credited back to the investors.

1 So what is the total amount of restitution
2 outstanding based on this document?

3 A. The total outstanding balance without any
4 interest is \$2,999,208.32.

5 Q. Okay. Now, you've got a couple other exhibits, I
6 believe, as S-57.

7 ALJ STERN: Just before you go to S-57, so in
8 other words, from the period we're talking, 2005 to 2012,
9 you're saying this is the amount of restitution that he
10 should make back to the investors, plus whatever the
11 interest is, \$2.9 million, almost \$3,000,000 plus
12 interest?

13 THE WITNESS: Correct.

14 ALJ STERN: Okay. Go ahead.

15 MR. HUYNH: Thank you, Judge.

16 BY MR. HUYNH:

17 Q. Mr. Callahan, can you flip to S-57?

18 A. Okay.

19 Q. Do you recognize this report?

20 A. Yes, I do.

21 Q. What is this report?

22 A. This report is a reconciliation between what I
23 have listed outstanding on the financial statements or I
24 refer to them as financial statements. They were the
25 cash sources and uses statements that we reviewed

1 yesterday about Richard Schmerman and Diversified
2 Financial. This lists out each investor that we
3 actually had come across, the amounts invested, the
4 amounts repaid, and the net figure. So this amount
5 could tie out to my financial statement, and then also
6 any adjustments we made to get to then the restitution
7 list.

8 Q. And this appears, you know, created, you know,
9 back in March 27 of 2012?

10 A. Uh-huh.

11 Q. So from this time frame to your recent one on
12 August 14, 2013, that we saw in S-58, did you get
13 additional information in and maybe additional payments
14 made by Mr. Schmerman to people?

15 A. We came across this, yes, some additional
16 information.

17 Q. So the numbers here might be slightly different
18 than S-58 because you took into account and made some
19 revisions and additions?

20 A. Correct, and I think we also -- we also used
21 this because we had -- the original notice had amounts
22 that were different than what we had, and this was the
23 number, my final, basically my final number when I got
24 done with all of the information we had brought in when
25 I created this list, so that, again, I could reconcile

1 between my source and use statements and what we end up
2 with the restitution for the investors.

3 Q. So when you say reconcile, meaning you can
4 account for why they're different?

5 A. Why they're different, yes.

6 ALJ STERN: Well, wait. I'm just a little bit
7 in the dark. I don't quite understand 57. Should the
8 number on here, the fourth page, the 531 -- no, that's
9 not correct.

10 There is no total then. This is just sort of an
11 accounting of where money went; is that sort of what it
12 is?

13 THE WITNESS: Well, I didn't want to include in
14 the restitution list people who received money back,
15 such as the Aikens, because they put in \$176,000 but had
16 received payments of \$181,000. So they would have a
17 negative balance.

18 ALJ STERN: I see.

19 BY MR. HUYNH:

20 Q. So this took into account everybody at the time,
21 and what you did is you also took out some people who
22 actually got their money back and removed them from the
23 list on the restitution of S-58?

24 A. Correct, or as in the case of the investor who
25 is Shirley Berman, I never saw her put any money into

1 her investment, but I saw her getting a repayment, but I
2 don't know how much she actually is owed.

3 ALJ STERN: Okay. But it doesn't prove anything
4 with respect to actual restitution?

5 THE WITNESS: No.

6 ALJ STERN: Okay.

7 THE WITNESS: These are the figures that I would
8 have in my database as far as all the details.

9 ALJ STERN: And overall then, in terms of the
10 period for restitution, we're talking a period of 2005
11 to 2012?

12 THE WITNESS: Correct.

13 ALJ STERN: We're not talking investors who may
14 have invested with him in 2001 and maybe dropped off the
15 chart after 2004? I mean you don't have that
16 information?

17 THE WITNESS: No, I do not. And several
18 investors actually provided me with their statements or
19 their original investments that went back to 2001. I
20 think Judy Pellish was one, but I had to way of tying
21 that out.

22 ALJ STERN: Okay.

23 BY MR. HUYNH:

24 Q. Just to be clear, so we're not going to be
25 referencing S-57. That was just for your own purposes if

1 you needed to explain any differences?

2 A. Yes.

3 Q. Okay. So S-58 is the chart that we're looking
4 at, and that's the most accurate, up-to-date one that you
5 have based on your records then?

6 A. Yes.

7 Q. Now, if we go back to S-58 real quickly, I had a
8 couple quick questions for you regarding a couple specific
9 individuals. I would like to look at Dr. Rolf Vrla.

10 A. Okay. He is located in the IA fees section.

11 Q. Okay.

12 A. Should be on the -- he's located on Page 5, I
13 believe. No, he's located on page 6, the last page.

14 Q. Now, you may not have been here during his
15 testimony, so let me take a second and flip through real
16 quickly here. Can you bring up S-64 real quickly?

17 A. Okay.

18 Q. And on S-64, could you flip to ACC 14823?

19 A. 14823. Yes, I have that, the check for \$9,965?

20 Q. Yes. That's a check made out to Diversified
21 Financial?

22 A. That is correct.

23 Q. Now, is that amount a payment made by Dr. Vrla to
24 Mr. Schmerman, is that reflected in your institutional
25 list here?

1 A. No, it is not.

2 Q. Do you know why that is?

3 A. Well, this, we received this after I had already
4 completed the schedule, and it is outside our time frame
5 that I have accounting records for. Or the bank
6 records, I should say.

7 ALJ STERN: Wait. Well, the check says, doesn't
8 it say August 25, 2011, on it, the one you're talking
9 about, Bates 14823?

10 THE WITNESS: And I think we only have
11 information, I believe, I thought it was April of 2011.
12 Not 2012.

13 BY MR. HUYNH:

14 Q. So just to be clear here, if you need to,
15 Mr. Callahan, did you need to refer back to your statement
16 of cash flows in S-55 and 54?

17 A. Well, I'll just refer to my notes. I know I
18 have some bank accounts that I have listed, and we only
19 have information from January of '05 until April. The
20 last date we have is April of 2011.

21 Q. From bank statements, okay. But between the
22 April of 2011 to parts of 2012, at times, did you maybe
23 receive documents from either investors or some other
24 sources giving you updated information that you accounted
25 for?

1 A. Yes. I think we even were still getting, during
2 that time period, bank detail statements and as far as
3 canceled checks and detailed information of what made up
4 various deposits. So yeah.

5 Q. Okay.

6 A. But I didn't get a copy of that check to update
7 my restitution list.

8 Q. Okay. So, in this instance, Dr. Vrla's \$9,965
9 was not something that you had obtained information on?

10 A. That's correct.

11 Q. And so that is actually missing from your
12 restitution list here?

13 A. That's correct. I would have to add him.

14 Q. Okay. So to have an accurate reflection of what
15 Dr. Vrla paid in those investment advisory fees after
16 March 11, 2010, your recommendation would be to add that
17 \$9,965 to his portion?

18 A. That's correct.

19 ALJ STERN: So if I understand you correctly,
20 then, the figure here of \$2,999,208 and some change is
21 now increased by almost \$10,000, right?

22 THE WITNESS: That's correct.

23 ALJ STERN: So the total restitution --

24 THE WITNESS: Will be going up.

25 ALJ STERN: -- will be going up. Okay.

1 BY MR. HUYNH:

2 Q. Now, Mr. Callahan, I would like you to also, if
3 you could, flip over to -- give me just a second here.

4 ALJ STERN: Could I ask you to possibly file a
5 revised or amended Exhibit S-58 --

6 MR. HUYNH: You bet, Your Honor.

7 ALJ STERN: -- with any corrections you want to
8 make to it after this proceeding, so we have an accurate
9 reflection. It will be in the docket, and it will be
10 admitted S-58, I guess we can call it amended.

11 MR. HUYNH: No problem, Your Honor.

12 ALJ STERN: Okay. Go ahead.

13 BY MR. HUYNH:

14 Q. Mr. Callahan, can you flip over to S-62?

15 A. Okay.

16 Q. And Mr. Callahan, can you flip to ACC 18187?

17 ALJ STERN: Where are you at, S-62?

18 MR. HUYNH: Yes, Your Honor.

19 ALJ STERN: Go ahead.

20 BY MR. HUYNH:

21 Q. Mr. Callahan, did you have a chance to briefly
22 meet Mrs. Judy Pellish at some point in time?

23 A. Yes, I did.

24 Q. And in the bottom of her document here, she has a
25 fund history of what she accounted for, payments she made

1 to Mr. Schmerman, and what she received back.

2 Based on her records here, did you see an
3 additional \$20,000 payment that she did not have reflected
4 in this schedule?

5 A. Yes.

6 Q. And did you account for that on your S-58?

7 A. Yes, I did.

8 Q. So what is the amount outstanding that you had
9 for Mrs. Pellish then?

10 A. Well, I don't -- I have several listed. I don't
11 know what they are --

12 Q. Maybe I can ask it this way. So based on your
13 S-58 restitution list exhibit, is the 7-21-05 payment of
14 \$20,000 the only payment that you have reflected that she
15 doesn't have a notation for?

16 A. Yes.

17 Q. Okay. So the difference then is she was
18 reporting \$95,000 roughly outstanding. Your figure would
19 be about \$20,000 higher?

20 A. Yes, I think it's -- well, going back to S-57,
21 this has the actual just totals, so I have Ms. Pellish
22 putting in \$115,000, getting repaid \$6,450 for having an
23 open, being owed \$108,550.

24 Q. So that's the approximate difference there is
25 that additional check, and maybe any other payments back

1 to her that you didn't have records of?

2 A. Yes.

3 Q. Okay. So other than those two differences that
4 were noted, do you recall any other differences that need
5 to be made to this restitution list at this point in time?

6 A. Not that I'm aware of. But we only have to make
7 one change, correct?

8 Q. So then Dr. Vrla's \$9,965 to be added?

9 A. Okay.

10 ALJ STERN: So if I understand you correctly
11 then, you're say something Mrs. Pellish apparently
12 forgot \$20,000 she gave him that you found and put in
13 her restitution amount?

14 THE WITNESS: Yes. Yes, that's correct.

15 ALJ STERN: And Dr. Vrla, in his case, his one
16 check came in a little bit late, and it's not included.
17 So the real revisions there, the only real increase then
18 will be the 9,000?

19 THE WITNESS: That's correct.

20 ALJ STERN: Her letter just doesn't quite total
21 up to what you total up to?

22 THE WITNESS: Yes, that's correct.

23 ALJ STERN: Okay. Go ahead, Mr. Huynh.

24 MR. HUYNH: Thank you, Your Honor.

25 BY MR. HUYNH:

1 Q. I think that's all the questions I had for this
2 witness.

3 ALJ STERN: Okay.

4

5

EXAMINATION

6 BY ALJ STERN:

7 Q. On S-58, I just want to make sure of something,
8 because I noticed in here somewhere -- I thought it was in
9 here. In S-58, did I see anything -- I thought I saw
10 something about fees or something for commissions that he
11 had earned. Am I mistaken or --

12 MR. HUYNH: I believe, are you talking about
13 roughly the fourth page, Your Honor, where there's a
14 little note that says IA fees after Yukolis?

15 ALJ STERN: Wait a minute. Fourth page?

16 MR. HUYNH: It's approximately the fourth page,
17 after Yukolis.

18 BY ALJ STERN:

19 Q. We're talking S-58?

20 A. Yes.

21 Q. Yeah, what is that?

22 A. That's just a title heading to separate -- the
23 first section is investors. The second section I put
24 the title as IA Fees.

25 Q. These are monies that these people were charged?

1 A. And paid after he was no longer a registered
2 investment adviser.

3 Q. Oh, okay. All right.

4 A. And then on the very last page you'll see above
5 the last two names the title of "Other," and that would
6 be the money he had taken from the Beauvais Trust and
7 then the loan he received from his client.

8 Q. Okay. But Dr. Vrla, was he just charged those
9 fees?

10 A. Yes.

11 Q. Those IA fees?

12 A. He actually sent the money, his investment
13 money, he sent it personally over to Charles Schwab, so
14 it went into his actual Charles Schwab account.

15 Q. Uh-huh. But I mean as far as his investment
16 funds, those didn't get misdirected, shall we say?

17 A. No, because they were actually in his --

18 Q. Account at Schwab?

19 A. In his account at Schwab. And Mr. Schmerman
20 sent him a bill saying, you know, I've done all these
21 services for you, and here is what you owe me for them.

22 Q. Okay. Because I was thinking, wait a minute,
23 there's some difference here, and I just want to make sure
24 I understand it. Okay.

25 Okay. So overall, Mr. Callahan, for the period

1 in question that we're talking -- your study of
2 Mr. Schmerman's investment activities on behalf of his
3 clients covers the period really 2005 to 2012, and we're
4 going to have a little bit more restitution actually owed
5 to those investors than is reflected in S-58, but it's
6 primarily due to that one check?

7 A. That's correct. And the investment was till
8 April of 2011.

9 Q. Okay. All right. But the period of time is 2005
10 to April 2011; is that right?

11 A. That's correct.

12 Q. Why am I thinking 2012? Oh, I just see this date
13 as of August 14, 2013, at the beginning.

14 A. And then the other one was 2012, that would have
15 been S-57.

16 Q. But that's not related to --

17 A. No, it is not.

18 Q. That has nothing to do with S-58.

19 Is it safe to say in this case this was sort of
20 operated like a Ponzi pretty much? I mean he was using
21 other people's money to pay other investors whose monies
22 never reached Schwab or whomever?

23 A. Yes, that's exactly what happened. He used one
24 investor's deposit to repay other investors.

25 ALJ STERN: I don't think I have any other

1 questions.

2 MR. HUYNH: None further from me, Your Honor.

3 ALJ STERN: Okay. Thank you, sir.

4 THE WITNESS: Thank you.

5 ALJ STERN: Any other witnesses, Mr. Huynh?

6 MR. HUYNH: No, Your Honor. The State rests its
7 case.

8 ALJ STERN: You said you wanted to make a brief
9 closing. You want to take a break for a few minutes?

10 MR. HUYNH: Yes, Your Honor. We would just need
11 five minutes just to make sure we set up the computer.

12 ALJ STERN: Okay. We'll take a break till
13 about, let's give us to ten till 11:00, and we'll be
14 back to do your closing and anything else.

15 MR. HUYNH: Okay. Thank you.

16 (Recessed from 10:34 a.m. to 11:02 a.m.)

17 ALJ STERN: We're back on the record, and while
18 we were off the record, Mr. Huynh has advised me we're
19 going to just do the amendment or the addition to
20 Exhibit S-58 at this time so that we don't have to have
21 any late-filed exhibits or whatever.

22 So, if I understand things correctly, Mr. Huynh,
23 S-58 that was previously admitted and is in your exhibit
24 book --

25 MR. HUYNH: Yes, Your Honor, what we would like

1 to do is, if we could just reopen briefly so we could
2 enter in S-58b as a new exhibit which would be a
3 revision, a minor revision to the restitution list.

4 ALJ STERN: Okay. Then we have the original
5 exhibit that's already been admitted. It's sort of hard
6 to unadmit it. So what we'll do is we will on your
7 motion then admit Exhibit S-58b. We won't need a
8 late-filed exhibit that I talked about earlier, and you
9 can proceed and go through S-58b, and I assume there
10 won't be a problem with it. Go ahead.

11 Mr. Callahan back on the stand.

12 MR. HUYNH: If we can recall Mr. Callahan back
13 on the stand.

14 ALJ STERN: Back on the stand. Let's finish
15 this up.

16

17 FURTHER DIRECT EXAMINATION

18 BY MR. HUYNH:

19 Q. Mr. Callahan, I would like you to look at S-58b.
20 Do you recognize this document?

21 A. I do.

22 Q. And who created this?

23 A. I did.

24 Q. And just to give a brief overview, what is the
25 difference between S-58b compared to the original S-58?

1 A. Well, I changed the date to reflect today's
2 date, and then I added the additional payment for
3 Dr. Vrla.

4 Q. And that was added under the IA fees area of
5 restitution?

6 A. That is correct. And I added the last payment
7 as the last payment under the Dr. Vrla area for the
8 \$9,965.

9 Q. Great. So the new total amount of restitution
10 owed is?

11 A. It will now be \$3,009,173.32.

12 Q. Okay. Thank you. I don't have any further
13 questions for this witness.

14 ALJ STERN: Thanks. Exhibit S-58b is hereby
15 admitted. Thank you, Mr. Callahan, for updating this.

16 (Exhibit S-58b was admitted into evidence.)

17 MR. HUYNH: Your Honor, I just had a quick
18 question. I know that we briefly had talked about S-57
19 as a reconciliation. The Division is open to
20 withdrawing S-57 to avoid confusion if that's okay with
21 the Court, or we can leave it.

22 ALJ STERN: I just know it doesn't have much
23 meaning to me, and it's just part of Mr. Callahan's
24 working materials.

25 MR. HUYNH: Okay. Then that's perfectly fine,

1 Your Honor.

2 ALJ STERN: I'll just write "Work Materials" on
3 it, "See end of transcript."

4 All right, Mr. Huynh, you're going to make a
5 closing statement, correct?

6 MR. HUYNH: Yes, Your Honor, if I could just
7 have a couple minutes.

8 ALJ STERN: That's fine. Then you're going to
9 file a brief, I assume, highlighting all the important
10 aspects of the testimony of the past couple days by the
11 witnesses --

12 MR. HUYNH: Yes, Your Honor.

13 ALJ STERN: -- adding up everything, and
14 informing us what we should know about it with respect
15 to the law and the fact that, I guess, Mr. Richard
16 Schmerman wasn't registered for a period of time as he
17 should have been.

18 Okay. Go ahead, Mr. Huynh.

19 MR. HUYNH: Thank you, Your Honor. Over the
20 last few days we've heard numerous instances of broken
21 trust, of Mr. Schmerman's dishonesty, and of his
22 unethical behaviors. For years he hid behind the veil
23 of a licensed investment adviser which he touted to his
24 clients. He fostered client trust by paying them
25 alleged interest payments and distributions from alleged

1 investments. Like a house of cards, it all came
2 crashing down on him.

3 We know now from Mr. Callahan's testimony that
4 very little of the clients' money actually went into
5 investing in stocks or securities for their benefit.
6 The bulk of the money went into Mr. Schmerman's bank
7 account that he actually used to pay back investors,
8 withdraw as cash, or to settle his personal debts and
9 expenses. No one was immune to his dishonesty, not even
10 his aunt.

11 So how did he continue for so long? You heard
12 the testimony of the numerous witnesses like Burritt
13 Steward and even his aunt Judy Pellish, and it was built
14 on the trust that was fostered between that special
15 relationship between an investment adviser and their
16 client.

17 The clients came to trust that relationship and
18 what goes on and the foundation of a licensed and a
19 registered individual, that they would follow the law,
20 that they would be bound by certain parameters, and that
21 they would have their best financial interests at heart.

22 Unfortunately, Mr. Schmerman abused that trust.
23 Mr. Schmerman was licensed for a short period of time as
24 a licensed investment adviser representative.
25 Completely different than an investment adviser. But

1 even for that less than two-year period of time, we saw
2 multiple pieces of evidence from the letters that he
3 submitted to clients dating all the way back to the
4 '90s, to the early 2000s, where he touted himself as a
5 licensed investment adviser.

6 He was never a licensed investment adviser.
7 Diversified Financial was never a licensed investment
8 adviser at any point in time. It wasn't until he got
9 terminated by United Planners did he come in on behalf
10 of Diversified Financial Planners, LLC, to file for
11 investment advisory application. That application is
12 still pending.

13 A couple days later he came in to file for
14 himself to be the investment adviser representative for
15 that entity. Again, that never got approved, and that
16 application is pending.

17 We also saw situations where he held a fiduciary
18 relationship. It was an additional heightened
19 relationship he had with individuals because of what he
20 entered into, specifically, the Beauvais Estate. Mrs.
21 Beauvais was a client of his, and he became a personal
22 representative and co-trustee on her trust account.

23 As a personal representative and co-trustee, he
24 had a heightened fiduciary standard to hold her best
25 interests at heart, and we saw from the evidence what he

1 did with that trust. He took her assets and used it for
2 his own personal gain. In many instances, you know,
3 right after she died, he named himself onto her own
4 personal SunWest bank account and even sold her property
5 which he brought into the account and used for his own
6 personal benefit.

7 We also saw that the Beauvais Estate was not the
8 only time he was accused of violating that trust, that
9 special relationship with a trust. We heard testimony
10 regarding the Ruth Gunston Estate. As you recall, in
11 that instance, Mr. Schmerman paid roughly \$780,000 out
12 of the total \$790,000 due back to the Ruth Gunston
13 Estate because somehow \$790,000 was missing from the
14 estate that he was a personal representative of.

15 You also briefly heard testimony that there was
16 allegations that he had to repay back thousands of
17 dollars to the estate of his own father because there
18 was a civil litigation between him and his sister.

19 With all the facts and evidence, we saw
20 Mr. Schmerman not only devastated lives, but he
21 devastated futures, and he also devastated his clients'
22 trust. In order to restore some of that trust back, I'm
23 asking that we send a public message against
24 Mr. Schmerman as a start, and I would like to walk
25 through some of our provisions within our Securities Act

1 and Investment Management Act that will allow you to do
2 so.

3 Specifically, because Mr. Schmerman was
4 registered as a securities salesman for the time frame,
5 I'm asking that you revoke his securities salesman
6 license pursuant to 1962. And you have the ability to
7 do so when an individual engages in dishonest and
8 unethical practices within the meaning of
9 44-1962(A)(10).

10 And when you look at 44-1962(A)(10), our
11 standards actually give you definitions of what is a
12 dishonest and unethical practice. And making
13 unauthorized use of funds of a customer or converting
14 customer funds for your own personal benefit is a
15 dishonest and unethical conduct. And that is found in
16 R14-4-130(A)(16). We saw that here in multiple
17 instances. Mr. Callahan detailed it in great detail
18 multiple times where he took client funds for his own
19 personal benefit.

20 In addition, borrowing money by a salesman of a
21 customer who is not a relative is also a violation and a
22 dishonest and unethical practice within the meaning of
23 14-4-130(A)(15). We saw instances of that regarding
24 Michael Durand. We had an individual who was a client
25 of his who gave him \$375,000. We also saw and heard

1 instances where he had a client by the name of Richard
2 Rubin; and as Mr. Thomsen testified, over the years
3 Mr. Rubin gave Mr. Schmerman multiple loans. One that
4 was noted was October 11, 2006, for \$100,000.
5 Mr. Rubin's name can be found on Exhibit S-22d as a
6 customer who he opened up a Schwab brokerage account
7 with, and he also took a personal loan from. Again, a
8 violation of the Act.

9 Mr. Schmerman also engaged in dishonest and
10 unethical practices in business or financial matters
11 within the meaning of 44-1962(A)(12). We saw multiple
12 instances such as when he named himself beneficiary of a
13 trust of the Beauvais Estate. We also saw a dishonest
14 and unethical practice when he sold her residence in May
15 of 2009, brought it into the SunWest account, and then
16 diverted it into his own personal bank accounts.

17 We again saw when he took \$162,000 from
18 Mr. Burritt Steward, and he used that money, instead of
19 investing like he told him he would, he used it to
20 settle his outstanding obligation to the Ruth Gunston
21 Estate.

22 Again, we can see in S-26c when he named himself
23 the beneficiary. We saw in those title documents when
24 he sold the estate, and even from Mr. Callahan's
25 exhibits what he did with the money afterwards. Again,

1 Mr. Callahan's exhibit showing how Mr. Steward's amount
2 of funds were used.

3 Now, because he was an investment adviser
4 representative for a short period of time, you also have
5 the ability to revoke that license, also. Under 44-3201
6 and 3202(D), the Division filed its action within two
7 years of that termination. In fact, we filed it roughly
8 about six months after he was terminated. So that
9 provides you the option to still revoke that investment
10 advisory representative license.

11 To do so, you just have to find it's in the
12 public interest; and based on everything we saw here, I
13 think you would agree revoking his ability to be an
14 advisory representative is in the public interest.

15 Specifically, if you look in that statute under
16 (A)(10), one of the options or grounds, in addition to
17 finding it's in the public interest, is he has been
18 suspended for longer than six months by an SRO. In this
19 case we saw FINRA barred him permanently, and I believe
20 that was S-60 or 61 was that exhibit.

21 Additionally, under 3201, you can revoke him if
22 he violates a chapter, if he violates Chapter 13. Under
23 44-3201(A)(3), he did violate a chapter. Specifically,
24 he committed fraud within the meaning of 3241. We saw
25 multiple instances where he did this. Again, fraud, the

1 fraud provision applies to any person, whether they're
2 registered or not; and we saw multiple times where he
3 misrepresented that he was registered and licensed as an
4 investment adviser.

5 We also saw many instances where he misled his
6 clients to pay him advisory fees after March 2010 when
7 in fact he couldn't even access the account. We also
8 saw him using client funds for his own personal uses.

9 Instances where he misrepresented what he was
10 going to do with the money, and as Ms. Aiken told you,
11 she was always under the impression that money was
12 actually funded by Schwab and was shocked to hear when
13 she contacted Schwab that not a penny actually made it
14 into that account.

15 Now, because he came in in May of 2010 with a
16 new application, the Division is also asking you to deny
17 that new application, also. You have grounds to do so,
18 because again, I believe you'll see it's in the public
19 interest, and the same type of grounds that you saw
20 earlier, which is he has been barred by FINRA, and
21 that's a ground under 3201(A)(8), and you saw the
22 dishonest and unethical practices that we've already
23 discussed, such as borrowing money from a client and
24 making misrepresentations, especially about his
25 registration and licensing status.

1 Now, in addition to the revocations, you can
2 also assess restitution, penalties, and make him cease
3 and desist. Again, very briefly, 1962 gives you those
4 grounds, and I ask that you also order that. I'm asking
5 that you order restitution in the full amount of roughly
6 \$3,000,000 that we discussed in Exhibit S-58b.

7 Again, under the Investment Management Act,
8 gives you grounds to order restitution, penalties, and
9 to cease and desist. Briefly, (A)(13) gives you those
10 opportunities by referencing the Administrative Code
11 because he borrowed money from a client and he also
12 misrepresented his qualifications.

13 So as we noted, we would ask for full
14 restitution. Again, that's the old figure. I would ask
15 for the \$3,000,000 that is listed in S-58b. I would ask
16 for a large administrative penalty in this situation of
17 at least \$200,000 for the egregious nature of what he
18 did, cease and desist, and the revocations. So thank
19 you.

20 ALJ STERN: Okay. Thank you, Mr. Huynh.
21 Anything else?

22 MR. HUYNH: That's it, Your Honor.

23 ALJ STERN: Okay. Thank you. This matter is
24 concluded. We'll take it under advisement, and the
25 Commission will take it up at Open Meeting and issue an

1 appropriate order.

2 MR. HUYNH: Your Honor, did you want to set a
3 deadline for our posthearing brief?

4 ALJ STERN: How about November 22?

5 MR. HUYNH: Okay, Your Honor.

6 ALJ STERN: Or make it the 29th. You probably
7 won't be here that day anyhow, after Thanksgiving.

8 MR. HUYNH: Okay.

9 ALJ STERN: The 29th is the deadline.

10 MR. HUYNH: Thank you, Your Honor.

11 ALJ STERN: Okay. Thank you.

12 (The hearing concluded at 11:20 a.m.)

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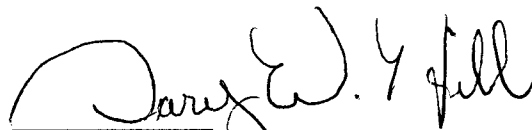
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1 STATE OF ARIZONA)
2) ss.
3 COUNTY OF MARICOPA)
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7 I, GARY W. HILL, Certified Reporter No. 50812
8 for the State of Arizona, do hereby certify that the
9 foregoing printed pages constitute a full, true and
10 accurate transcript of the proceedings had in the
11 foregoing matter, all done to the best of my skill and
12 ability.

13
14 WITNESS my hand this 17th day of October,
15 2013.
16
17
18

19 

20 GARY W. HILL, RPR, CRR
21 Certified Reporter
22 Certificate No. 50812
23
24
25